[redacted]

B

Declaration of Professor Jerry A. Hausman

1. My name is Jerry A. Hausman. I am MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139.

2. I received an A.B. degree from Brown University and a B. Phil. and D. Phil. (Ph.D.) in Economics from Oxford University where I was a Marshall Scholar. My academic and research specialties are econometrics, the use of statistical models and techniques on economic data, and microeconomics, the study of consumer behavior and the behavior of firms. I teach a course in "Competition in Telecommunications" to graduate students in economics and business at MIT each year. In December 1985, I received the John Bates Clark Award of the American Economic Association for the most "significant contributions to economics" by an economist under forty years of age. I have received numerous other academic and economic society awards. My curriculum vitae is included as Exhibit 1.

3. I have done significant amounts of research in the telecommunications industry. I have published numerous papers in academic journals and books about telecommunications. I have also edited two books on telecommunications, Future Competition in Telecommunications (Harvard Business School Press, 1989) and Globalization, Technology and Competition in Telecommunications (Harvard Business School Press, 1993). Among my recent papers in telecommunications are: "Valuation and the Effect of Regulation on New Services in Telecommunications," Brookings Papers on Economic Activity: Microeconomics (1997), J. Hausman & H. Shelanski, Economic Welfare and Telecommunications Welfare: The E-Rate Policy for Universal

Service Subsidies," Yale Journal on Regulation (1999), and J. Hausman & G. Sidak, "A Consumer-Welfare Approach to the Mandatory Unbundling of Telecommunication Networks," 109 Yale Law Journal 417 (1999).

I. Summary and Conclusions

4. SBC has asked me to address issues related to the effect of the MCI WorldCom/Sprint merger on long distance and Internet backbone services. SBC has particular interest in the long distance and Internet backbone businesses not becoming less competitive. SBC sells exchange access services. If long distance prices increase as a result of this merger, the volume of long distance calls originating or terminating in SBC's local exchange service area will decrease, which will cause a decrease in the volume of access services SBC sells. Moreover, SBC is a customer for wholesale long distance service for its wireless business today and will purchase even more transport in the future as it enters the long distance business. SBC is also a customer of Internet backbone services and, through its recently announced joint venture with Prodigy, is seeking to expand its role as an Internet service provider.

5. The FCC-defined market of "mass market" long distance has three significant branded carriers: AT&T, MCI WorldCom, and Sprint, along with numerous "generic" carriers, including dial-around or "1010" providers, of which MCI WorldCom's 1010321 and 1010220 are the largest. The Big Three branded carriers have between 75%-80% of the mass market for long distance.

6. MCI WorldCom and Sprint are each other's closest competitors. The combination of MCI WorldCom with Sprint would allow the exercise of unilateral

market power by the combined company to raise (or not to lower) long distance prices. Econometric analyses shows that elimination of Sprint by merger is likely to lead to price increases of 5.4% (for MCI's prices) and 8.9% (for Sprint's prices), all other things being equal. Furthermore, Sprint has a special position as the downward price leader in segments of the mass market. Sprint's role has been that of a pricing innovator, often followed by MCI and subsequently by AT&T. A merger of Sprint with MCI WorldCom would lead to decreased pricing innovation and higher prices in the mass market.

7. The BOCs have a potential competitive role in the mass market for long distance because of their strong regional brand names and established customer bases. However, I show below that, because of the requirement that prices be uniform across the country, the BOCs would need to be effective competitors for long distance for a significant proportion of the population before they could begin to constrain the pricing of the Big Three. Moreover, the BOCs would not necessarily be able to replace Sprint as a close competitor of MCI WorldCom. Since it is uncertain as to when the entry may occur, the future entry by the BOCs does not mitigate the immediate anticompetitive impact of this transaction. A further potential problem arises because the BOCs will need to purchase wholesale long distance transport service out of their regions. The three ubiquitous wholesale networks of AT&T, MCI WorldCom, and Sprint will be reduced to two networks, with the potential for decreased competition and higher wholesale prices.

8. Even if the merging parties' argument that a market for bundles of telecom services is evolving is correct, the proposed acquisition of Sprint by MCI WorldCom would decrease competition for bundles of telecom services. Consumers and small business have expressed their preferences repeatedly in market surveys for the ability to

buy bundled packages of telecommunications services. AT&T, MCI, and Sprint all have stated publicly that they believe it is important competitively to be able to offer one-stop shopping. The Commission has emphasized the importance of the long distance component of a successful bundle offered to residential and small business customers. MCI WorldCom and Sprint currently are the two interexchange carriers, besides AT&T, with established brand names and consumer recognition that currently can provide bundled offerings with the crucial component of long distance services.

9. Importantly, for bundled services, it would not be sufficient to have even a significant proportion of residential customers able to choose BOC long distance service. When offering bundled services, no obligation would be imposed on long distance firms to charge uniform nationwide prices for the non-interexchange portions of the bundle. Rather, providers of bundled services would likely charge different prices in different geographical areas depending on differences in costs and differences in competitive situations. In the absence of nationwide pricing for bundles, it would be necessary for almost every BOC to receive Section 271 permission in almost every state to provide long distance so that the BOCs could offer bundles of services, or the current merger would lead to a significant decrease in competition in this area.

10. Internet backbone providers (IBPs) provide a key input component to Internet Service Providers (ISPs). The acquisition by MCI WorldCom of Sprint will combine the number one and number two IBPs. Large IBPs can use their market power to impose supracompetitive interconnection agreements on smaller IBPs and ISPs. They can also degrade the quality of interconnection with other parties on the Internet. The

acquisition will lead to an increase in market power and higher prices to portals (*e.g.*, Yahoo) and ISPs, which will lead to higher prices to advertisers and consumers.

II. Mass Market Long Distance

11. The FCC-defined market of "mass market" long distance has three significant branded long distance carriers, AT&T, MCI WorldCom, and Sprint, along with numerous non-branded dial-around or "1010" providers, of which MCI WorldCom's 1010321 and 1010220 are the largest.[1] Other much smaller and weaker branded offerings also exist (for purposes of this paper, I combine the small and weak branded offerings together with the non-branded dial-around offerings in discussing competition and refer to the combination as "generic" carriers or "Other Carriers"). The "Big Three" branded carriers have between 75%-80% of the mass long distance market. Three questions are addressed in this section. First, are the prices of the three large brands constrained by the "generic" carriers? If the answer to this question is "No," the acquisition of Sprint by MCI WorldCom will reduce the number of significant branded carriers to a duopoly, with an anti-competitive outcome quite likely. Second, is Sprint a closer competitor to MCI WorldCom than AT&T or others? If so, its elimination by merger would have a greater anti-competitive effect than its market share would otherwise indicate. Third, is it clear that the anti-competitive effects of this merger would be eliminated by BOC entry into long distance services in the near term? If not, BOC entry does not save this merger.

---

[1] AT&T also has a significant 1010 carrier.

A. Market Definition

12. The FCC has defined a "mass market" long distance market, comprised mainly of residential customers and single line business customers. This product market meets the criteria contained in The Department of Justice/Federal Trade Commission Merger Guidelines ("MG") of a "hypothetical monopolist" being able to increase price by 5% in a profitable manner.[2] In terms of geographic market definition, the FCC has found that a nationwide market exists. Long distance carriers price on a per minute basis for calls anywhere in the country, not on a distance basis. Also, the Telecom Act of 1996 specifies that carriers may not charge different long distance prices in different states or charge different prices in urban and rural areas.[3]

13. The provision of long distance services to mass market customers is a differentiated product market. Significant brand advertising exists with different product attributes offered by different long distance carriers. In particular, the products differ in monthly fees and per minute charges. The branded carriers tend to charge monthly fees and varying per minute charges. The dial-around carriers offer a number of different packages, *e.g.*, $0.99 for 20 minutes, and no monthly fee. Other "generic" companies, *e.g.* Qwest, charge significantly below the Big Three carriers without gaining large amounts of market share. For instance in December 1998 Qwest's customers paid

---

[2] MCI WorldCom affiants, Drs. Besen and Brenner, also use this market definition. Declaration of Stanley M. Besen & Steven R. Brenner, *In re Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications, Corporation to WorldCom, Inc.*, CC Docket No. 97-211 (filed November 17, 1999) ("B&B Declaration").

[3] 47 U.S.C. § 254 (g).

approximately 12% less for peak period calls and 7% less for off peak calls that AT&T customers, yet Qwest did not take away significant share from AT&T.[4] The product is not homogenous, where small price differences cannot exist for long because of high price elasticities in homogenous goods markets. Thus, the long distance products are not perfect substitutes for each other. Instead, there are three heavily branded products along with numerous other "generic" carrier products.

14. Contrary to the Applicants' claims, no so-called "all distance" market that combines local and long distance calls exists for competitive analysis of landline telephone service. For the mass market the service is rarely offered and is not purchased by a significant proportion of customers. Because of the historic pattern of "free" local calls in the U.S. for residential customers enforced by state regulation, no so-called "all distance" market exists where a hypothetical monopolist could raise prices by a significant non-transitory amount.[5] While the long distance market may develop so that a significant proportion of customers buy "bucket" calling plans that permit a large number of long distance minutes for a fixed monthly fee, rather than a per minute charge being used, for the medium term I expect the ILECs to continue to offer local calling for "free." State regulators will require the ILECs to continue to offer this residential service offering, which is often subsidized by other ILEC services.

---

[4] Calculations using household bill harvesting data from PNR Associates.

[5] This situation differs from mobile telephone where "free" local calls were never offered.

B. Market Concentration

15. Because the merger would combine two of the three branded carriers, analyzing the product first as homogenous, rather than as differentiated, would clearly understate the anticompetitive effect. Using revenue data from the FCC on all long distance services (including both intraLATA toll and interLATA toll), the post-merger firm would have a combined market share of 32.4%, only slightly behind AT&T's 38.7%. The firm with the largest share other than the combined MCI WorldCom/Sprint and AT&T would be Qwest, and its share is only 2.2%.[6] The merger increases the concentration of this market, as measured by HHIs, by 433 – from a pre-merger HHI score of 2199 to a post-merger HHI score of 2632.[7]

16. This concentration analysis includes intraLATA toll service offered by ILECs, because the FCC does not provide separate data on interLATA toll and intraLATA toll revenues. Using toll revenues from carriers other than ILECs to approximate interLATA toll revenues alone, the merger increases market concentration in interLATA toll services even more significantly. Using this estimate for interLATA toll services, the pre-merger HHI is 2662 and the post-merger HHI is 3199, for an increase of 537 points. This increase in HHI is more than 100 points greater than the increase in a market that includes all toll calls.

---

[6] Revenue data from FCC, Industry Analysis Division, "Trends In Telephone Service" (September 1999) ("FCC Trends in Telephone Service").

[7] The FCC's report combines all RBOCs (which it estimates have a 6.5% market share), all other ILECs (which it estimates have a 2.5% market share), and all other CAPs, CLECs and other LECs (which it estimates have a 1.2% market share). The HHI calculations presented above use these aggregated market shares for these groups. Disaggregating these data would result in slightly different HHIs.

17. In terms of residential direct dial toll minutes AT&T has 61.7 %, MCI has 14.8%, and Sprint has 6.2%, so the change in the HHI is 184 with a post-merger HHI of approximately 4248.[8] In terms of residential toll revenue AT&T has 58.3%, MCI has 18.4%, and Sprint has 5.7%, so the change in the HHI is 210 with a post-merger HHI of approximately 3991.[9] These calculations take MCI's dial-around offerings to be independent products. More realistically, if they are included as an MCI product, the combined MCI WorldCom and Sprint share increases from 21.0% to 23.8% so that the change in the HHI is 295 with a post-merger HHI of 4707.[10] Similar results arise if revenue shares are used with a change in the HHI of 172 or 264, depending on whether MCI's dial-around offerings are included in its share.

C. Competitive Analysis

18. The economic analysis question is first whether these "generic" carriers constrain the prices of the Big Three branded products. Note that "generic" or "store brands" are quite common in consumer products, *e.g.*, soda, tissue, ice cream, pasta, beer, breakfast cereals, and color film.[11] In the usual situation, generic products are not

---

[8] FCC, Industry Analysis Division, "Long Distance Market Shares," Fourth Quarter 1998, March 1999, Tables 4.1-4.3.

[9] FCC Trends in Telephone Service, 11-11. The stated source of the data is PNR Associates.

[10] B&B Declaration, Table 111-2.

[11] I have analyzed these products and competitive interaction in a number of papers: J. Hausman, G. Leonard & D. Zona, "Competitive Analysis with Differentiated Products," with G. Leonard & D. Zona, Annales, D'Economie et de Statistique 34 (1994); J. Hausman, "Valuation of New Goods Under Perfect and Imperfect Competition," The Economics of New Goods (T. Bresnahan & R. Gordon eds., 1997); J. Hausman & G.

(Footnote continued...)

sufficient to constrain the price of branded products. Otherwise, the branded products could not earn sufficient gross margins to fund the advertising that differentiates the brands.

19. Advertising is very important for residential long distance competition. MCI WorldCom spent over $100 million in a yearlong television advertising campaign featuring Michael Jordan and Looney Tunes character, Bugs Bunny.[12] MCI WorldCom was reported to have spent approximately $950 million for advertising in 1998.[13] Similarly, AT&T heavily promotes its "7 cents plan" with television advertising and spent $1.4 billion on advertising in 1998. Sprint also uses television for its nickel nights program. AT&T and MCI WorldCom were in the top 20 largest advertisers in 1998 while Sprint was number 31, spending approximately $670 million.[14] These large advertising expenditures are designed to differentiate long distance products and to build brand loyalty. Thus, mass market long distance services are branded products with a significant degree of product differentiation.

(...continued)

Leonard, "Economic Analysis of Differentiated Products Mergers Using Real World Data," with G. Leonard, 5 George Mason Law Review 3 (1997). *See also* C.K. Robinson, "Quantifying Unilateral Effects in Investigations and Cases," 5 George Mason Law Review 3, (1997); J. Baker & T. Bresnahan, "The Gains from Merger or Collusion in Product-Differentiated Industries, Journal of Industrial Economics 33 (1985).

[12] Advertising Age, <http://adage.com/search97>.

[13] Advertising Age, <http://adage.com/cgi-bin/adage.cgi>. Not all of the advertising was for mass market long distance, but a significant proportion is for these services. Other advertising also increases brand awareness.

[14] AT&T and MCI WorldCom were also among the 20 largest network and cable TV advertisers in 1998. Advertising Age, <http://adage.com/dataplace/lna/index.html>.

20. MCI/WorldCom/Sprint's economists filing affidavits or declarations in support of the FCC application offer no economic analysis to address the competitive significance of competition from "generic" carrier long distance services. For example, they do not provide any evidence on the cross price-demand elasticities that would support their claim of a high degree of a price constraining effect by the "generic" carrier offerings. While Drs. Besen and Brenner discuss the amount of new wholesale capacity entering the market, they ignore the point that a number of these companies, *e.g.*, Qwest, have been unable to market their retail offerings successfully. Nor do MCI WorldCom's and Sprint's economists seek to demonstrate that the elimination of Sprint as an independent firm is not likely to have a significant impact on the prices paid by MCI WorldCom's and Sprint's current customers.

21. Among the branded products, MCI WorldCom and Sprint are closer competitors to each other than either is to AT&T. Both MCI WorldCom and Sprint have typically offered lower prices than AT&T. Currently, MCI WorldCom and Sprint both offer 5 cent per minute calls off-peak (with a monthly charge), and much higher rates on-peak. AT&T's two primary discount plans offer 7 cents (plus a monthly charge) for calls at any time or 15 cents (with no monthly charge) for calls at any time.[15] Thus, both Sprint and MCI WorldCom are targeting price-sensitive customers who will make most of their long distance calls off-peak, while AT&T has chosen a different strategy.

---

[15] AT&T's other two plans for either 12 cpm (cents per minute) or 10 cpm are not differentiated by time of day. AT&T does offer an all day 5 cpm plan, but it has a relatively high monthly fee of $9.95. A customer would need to have in excess of 250 minutes per month before the plan becomes economical compared to the more heavily advertised 7 cpm plan.

22. Econometric analysis confirms that Sprint is a closer competitor to MCI WorldCom than either AT&T or the "generic" carriers. Data from approximately 20,000 telephone bills from the PNR and Associates database have been analyzed.[16] I specify and estimate an econometric model that combines the choice of long distance carriers together with minutes called per month by individual residential customers. The model combines discrete choice analysis for the carrier decision and instrumental variable estimation of the usage equation. As demonstrated in the table below, this analysis reveals that Sprint's cross price elasticity with MCI WorldCom is over twice the cross price elasticity of AT&T and almost twice the cross price elasticity of the "generic" carriers. Thus, Sprint is the closest competitor to MCI WorldCom according to the cross price elasticity estimates. MCI WorldCom is also the closest competitor to Sprint, based on the econometric estimates.

---

[16] The details of this analysis are presented in Exhibit 2 to this Declaration entitled, "Econometric Model and Calculation of Post-Merger Price Changes." *See also* J. Hausman and G. Leonard, "Economic Analysis of Differentiated Products Mergers Using Real World Data," 5 George Mason Law Review 3 (1997). The PNR data are derived

(Footnote continued...)

Table 1

Estimates of Own Price and Cross Price Elasticities[17]

	Other Carriers	AT&T	MCI	Sprint
Other Carriers	-1.33	0.47	0.12	0.04
AT&T	0.16	-1.12	0.09	0.03
MCI WorldCom	0.23	0.50	-1.33	0.06
Sprint	0.30	0.61	0.22	-1.81

23. The MG recognize that a merger between firms in a differentiated product market may let the merged firm unilaterally raise the price of one or both of the products above the premerger level. The MG state: "Some of the sales loss due to the price rise merely will be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable premerger." MG, ¶ 2.21. The cross-elasticity estimates demonstrating that MCI WorldCom and Sprint are each other's closest competitors indicate that Sprint currently places a significant constraining influence on MCI WorldCom's prices. The removal of that constraint by merger will be

---

(...continued)

from a nationwide monthly sample of residential bills. They are used by the FCC in deriving long distance usage statistics.

[17] The cross price elasticities are calculated as the log change in the quantity of the row with respect to the log change in the price of the column, *e.g.*, 0.22 represents approximately a 2.2% change in Sprint's quantity for a 10% change in MCI's price. Thus, the largest effect of a MCI price change is on Sprint, and the largest effect of a Sprint price change is on MCI.

anti-competitive unless other competitors can replace the decrease in competition. Dial-around competitors are not a sufficient constraint, particularly given that MCI WorldCom supplies nearly one-half of the dial-around minutes. Again the merging parties' economists provide no evidence of a low cross-price elasticity between Sprint and MCI WorldCom or a high cross-price elasticity between MCI WorldCom and the dial-around carriers.

24. Econometric analysis also demonstrates that significant price increases resulting from this merger are predictable. Using the results of the econometric model described in the attachment and a Nash-Bertrand model of competition, MCI's prices are predicted to increase 5.4% post-merger while Sprint's prices are predicted to increase by 8.9%.[18] Thus, MCI and Sprint are sufficiently close substitutes that a significant price increase occurs when they jointly set prices. This outcome would cause significant consumer harm.[19]

25. Repositioning by a current carrier might also affect competitive outcomes. However, it is extremely unlikely that current carriers such as Qwest can reposition themselves to be significant competitive alternatives for mass market customers. They have failed to do so up to this point, and the FCC has not allowed them to jointly market

---

[18] For further explanation of this analysis, see Exhibit 2 to this Declaration, "Econometric Model and Calculation of Post-Merger Price Changes." *See also* J. Hausman, G. Leonard, & D. Zona, "Competitive Analysis with Differentiated Products," Annales, D'Economie et de Statistique 34 (1994).

[19] Decreases in marginal cost that arise from efficiencies can lead to decreased price effects from the merger. *See* J. Hausman & G. Leonard, "Efficiencies from the Consumer Viewpoint," George Mason Law Review 1999. However, MCI WorldCom's submission to the FCC does not identify or estimate any decreases in marginal costs for mass market long distance.

their products with the BOCs, which would have created additional competition. Thus, pointing to the existence of numerous carriers with expanding capacity, as do Drs. Besen and Brenner (pp. 11-20, 28-33), does not solve the competitive problem raised by the merger for mass market customers. The three branded carriers have excess capacity themselves, but have not used it to drive prices toward marginal cost. The merger would eliminate one of the three significant branded mass market long distance carriers, and there is no evidence to suggest that replacement for this lost competition will arise from the current array of carriers.

26. Entry of new branded products could also mitigate the potential price increasing effects of a merger between two closely competing branded products. However, no new entry of a significant new carrier for mass market customers across a significant proportion of the U.S. is likely to occur in the near future. As explained below, a BOC is permitted to offer long distance services in its own region in only one state, New York. But the approval of Bell Atlantic's Section 271 application for New York, for example, is not going to increase long distance competition in Florida or Arizona. And only one other 271 application is now pending at the FCC. Moreover, even when the BOCs eventually enter this business on a broad scale, there is no evidence to suggest that they could or would replace Sprint as MCI WorldCom's closest mass market competitor. Thus, there is no evidence to support claims that BOC entry will protect consumers from the anticompetitive effects of this merger.

27. Another anti-competitive effect is also likely. Only two branded firms would remain--AT&T and WorldCom. The reduction in the number of independent firms from three to two makes co-ordinated interaction more likely to occur. *See* MG,

¶ 2.1. The long distance market has been characterized by parallel pricing by the branded carriers. This oligopoly behavior has led to prices well above incremental costs.[20] Signaling prices in this market is relatively easy since they are heavily advertised and are listed on the companies' Internet web sites by FCC requirements. Carriers are also required to file tariffs with the FCC. Detection of deviations is straightforward because of the public nature of the pricing. Lastly, punishment is a credible threat given the large amounts of capacity that each carrier has.

28. Thus, with only two branded firms remaining post-merger, the likelihood of co-ordinated interaction would increase significantly. AT&T has not initiated any significant price cutting actions, instead following MCI WorldCom, which typically followed Sprint. Post-merger, MCI WorldCom/Sprint can decide whether or not to institute any price cuts, unconcerned that AT&T may attempt a price cut of its own. After the merger both AT&T and MCI WorldCom/Sprint could decide to decrease

---

[20] I have discussed coordination among long distance carriers in previous declarations to the Commission. *See e.g.*, Declaration of Professor Jerry A. Hausman, *Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, CC Docket No. 98-121 (filed July 9, 1998) ("Hausman BellSouth Declaration"). For a more recent analysis, see Declaration of Paul W. MacAvoy in Support of Bell Atlantic's Petition to Provide In-Region InterLATA Telecommunications Services, *Application by New York Telephone Company (d/b/a Bell Atlantic-New York), Bell Atlantic Communications, Inc., NYNEX Long Distance Company, and Bell Atlantic Global Networks, Inc. for Authorization to Provide In-Region, InterLATA Services in New York*, CC Docket No. 99-295 (filed Sept. 21, 1999). *See also* Affidavit of Richard L. Schmalensee and Paul S. Brandon, *Application by SBC Communications Inc., Southwestern Bell Telephone Company and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance, for Provision of In-Region, InterLATA Services in Texas*, CC Docket No. 00-4 (filed Jan. 10, 2000).

advertising and return to their previous lock-step pricing practices (which still prevail with respect to basic rates), which would decrease competition and harm consumers.

29. Post-merger, the Big Three branded carriers would become the Bigger Two branded carriers, with little likelihood of a non-BOC branded carrier becoming a significant competitor. Thus, the branded carriers become a duopoly of AT&T and MCI WorldCom, without a significant constraint by "generic" carriers. Indeed, WorldCom supplies a significant portion of the "competitive fringe." This situation would greatly increase the ability of AT&T and MCI WorldCom to engage in co-ordinated interaction as I discussed above.[21]

D. Sprint's Special Role

30. Sprint instituted the "Dime Lady" who subsequently became the "Nickel Lady." This advertising proved highly effective, and forced MCI to follow Sprint's lower price strategy. Sprint's innovation has been a primary source of whatever price competition there has been in mass market long distance services and has led to significant gains in consumer welfare. Subsequently, AT&T followed MCI, although not down to the same price level. Here is a history of recent price moves among the Big Three branded carriers:

---

[21] The industrial organization literature has explored how, with only two firms, detection of cheating from an agreement is simplified. *See e.g.*, A. Jacquemin & M.E. Slade, "Cartels, Collusion, and Horizontal Merger," in R. Schmalensee & R. Willig, Handbook of Industrial Organization Chapter 7 (1989).

September 1996: AT&T has a flat rate plan of 15 cents per minute (cpm) as does Sprint. MCI is at 14.5 cpm. Sprint announces a 10 cpm rate any time to the number you call most.

September 1997: MCI offers a plan of 5 cpm on Sundays, 10 cpm weeknights and Saturdays, and 25 cpm weekdays.

September 1997: Sprint offers free calls on Monday nights.

February 1998: MCI offers 5 cpm Sundays and 9 cpm other times to customers who enroll online and automatically pay by credit card.

June 1998: Sprint offers 10 cpm anytime ($4.95 monthly fee waived if monthly bill more than $30).

September 1998: AT&T offers 5 cpm weekends, and 10 cpm weekdays with a $4.95 monthly fee.

November 1998: Sprint offers unlimited free weekend calls with all other times at 10 cpm for $25 monthly fee.

July 1999: Sprint offers "Nickel Nights" with 5 cpm off peak, 10 cpm peak with a monthly fee of $5.95.

August 1999: MCI offers a 5 cpm plan for off peak. Weekdays on peak are 25 cpm. The plan has a $1.95 monthly fee.

August 1999: AT&T responds with a 7 cpm plan at all times with a monthly fee of $5.95.

December 1999: Sprint expanded its discount plan for "Nickel Nights" to offer one free hour of calling on Sunday nights for 6 months after a customer signs up. It is too early to see what the competitive response of MCI WorldCom and AT&T will be to the new Sprint offering.

Thus, Sprint led multiple price reductions, MCI instituted three, and AT&T never did.

31. The recent history recounted above demonstrates Sprint, through its pricing innovations, has almost always led prices down among the Big Three branded carriers, to the extent prices have gone down for higher-volume and price-sensitive callers. After a certain interval MCI has followed, and lastly AT&T has finally caved in.

Indeed, Sprint has a greater economic incentive to deviate from the terms of coordination than do MCI WorldCom or AT&T because Sprint's mass market share has been at about 7% for a long time and it has a great deal of "excess capacity" to fill. Sprint has consistently been the smallest of the three branded carriers so that it has the smallest base of sales on which to enjoy "elevated profits" before cutting prices. Elimination of Sprint would reduce the economic incentives for the merged company to introduce innovative pricing policies and a likely outcome would be that the merged company and AT&T would introduce significantly fewer pricing innovations, which would lead to decreased consumer welfare.

E. The Importance of Potential BOC Entry

32. Drs. Besen and Brenner emphasize the competitive importance of BOC entry in the interLATA long distance market. In particular, they state (at ¶ 52) that "RBOCs have strong reputations that will afford them a high degree of customer acceptance once they receive Section 271 authority."[22] I am pleased to see that MCI WorldCom and Sprint finally recognize the important pro-consumer benefits of BOC entry.[23] Of course, MCI WorldCom historically has been, along with AT&T, the leading opponent of BOC entry into long distance, because MCI WorldCom did not want the

---

[22] Drs. Besen and Brenner fail to note that their emphasis on the importance of reputation to customer acceptance contradicts their previous emphasis on the price constraining effect of generic (no brand reputation) dial-around companies.

[23] *See* Hausman BellSouth Declaration.

increased competition. And they continue to do so, as both companies very recently filed oppositions to SBC's 271 petition for Texas.

33. The Applicants argue that BOC entry into the four states of New York, Texas, California, and Florida (or other states encompassing 33% of originating residential interLATA traffic) would be sufficient to constrain the increased market power created in mass market long distance services by this merger. (Application, p. 53.) I agree that once the BOCs become effective competitors in states containing a significant proportion of the U.S. population they should be able to constrain, to some extent, post-merger price increases, under current federal regulation.[24] It is by no means clear, however, when the FCC will approve enough BOC applications for this to happen.

34. The requirement in the Telecommunications Act of 1996 that providers of interexchange services charge the same rates for interstate services in each state in which they offer service means that the Big Three, each of which offers service in all (or almost all) states, will not maximize their profits by reducing prices nation-wide in response to BOC entry in a single state. BOC entry is not likely to lead to reductions in interstate rates charged by the Big Three until enough traffic originates in states in which BOCs have had their Section 271 applications approved and have become meaningful competitors to make a price response by the Big Three to that entry profit-maximizing. Not only is that result uncertain as to timing, it is not sufficient to alleviate competitive concerns because there is no evidence that the BOCs will choose to pursue the pricing or other strategies that made Sprint and MCI WorldCom each other's closest competitors.

---

[24] See the "critical share" calculation in J. Hausman, G. Leonard & C. Vellturo, "Market Definition Under Price Discrimination," 64 Antitrust Law Journal (1996).

Moreover, there are even greater concerns about bundled services, as discussed in Section III below.

F. Impact of Wholesale Services

35. In addition to combining two of the three leading retail providers of long distance service, the proposed merger of MCI WorldCom and Sprint also combines two of only three long distance networks that have ubiquitous coverage throughout the U.S. New networks, such as Qwest, Williams, BroadWing, and Level 3, do not have facilities in all areas throughout the U.S., nor do they have plans to do so. As a result, there are a significant number of areas in the U.S. in which there will be a substantial effective reduction in the number of long distance suppliers that originate and/or terminate traffic.

36. This merger is likely to adversely affect competition in wholesale services because it reduces the number of wholesalers who can provide ubiquitous nation-wide coverage from three to two. The new long distance networks need to obtain services (such as private line and/or wholesale switched services) in areas in which they do not operate in order to offer ubiquitous national coverage to their wholesale and retail customers. However, these networks often face a limited number of alternative suppliers of these "off net" services. The merger of two of the three national suppliers substantially reduces the number of alternative suppliers in many off-net areas. Increases in rates charged for the provision of service in these "off-net" locations raises the cost of providing services to new networks and adversely affects their ability to compete with the major carriers in providing long distance services. Thus, firms such as SBC, which plans to resell long distance services provided by Williams, which in turn it buys from Sprint,

can be adversely affected by a reduction in competition among firms providing service to areas in which entrants have not deployed facilities.

37. The number of areas served by a long distance network is approximated by the number of "points of presence" or "POPs" it operates. These POPs are facilities in which the long distance carriers' networks interconnect with networks operated by local exchange carriers. As shown below, the number of "POPs" served by AT&T, MCI and Sprint far exceeds the number served by other networks:

Table 2

Areas Served by Long-Distance Networks: 2000[25]

		LATAs	Population
Company	POPs	Served (%)	Served (%)
AT&T	**705**	**100%**	**100%**
MCI WorldCom	**740**	**99%**	**100%**
Sprint	**398**	**97%**	**99%**
Qwest	136	55%	81%
Williams	110	49%	78%
Frontier	92	44%	72%
BroadWing	77	34%	63%
Cable and Wireless	35	16%	48%
Level 3	26	13%	44%

[25] CCMI QT9000 Master Rate Center File; Qwest; Williams; Frontier; BroadWing; Level 3. Includes POPs scheduled to be deployed in 2000.

38. The proposed transaction reduces the number of carriers serving virtually all LATAs in the U.S. from three to two. As shown below, over 10 percent of the population will see a reduction in the number of facilities-based long distance carriers from three to two. Almost 20 percent of the population will reside in areas that are served by only three facilities-based long distance carriers.

Table 3

Population Affected by the Reduction in the Number of Long Distance Networks in Various LATAs Following Proposed Merger[26]

Number of Carriers		Population in LATAs		
Before	After	LATAs	% Total	Cum. %
2	**2**	**5**	**0.7%**	**0.7%**
3	**2**	**53**	**10.2%**	**10.9%**
4	**3**	**31**	**7.8%**	**18.7%**
5	4	27	9.2%	27.9%
6	5	27	12.9%	40.8%
7	6	16	9.7%	50.5%
8	7	16	14.5%	65.0%
9	8	15	35.0%	100.0%

39. The merger between WorldCom and MCI in 1998 combined the second and fourth largest long distance networks in the U.S. Nonetheless, those circumstances differed substantially from the proposed transaction. That is because WorldCom's network had served only about half of all LATAs and thus was substantially less widespread than those operated by AT&T, Sprint and MCI. In terms of LATAs served and population coverage, the (correctly) anticipated coverage of several of the new

[26] *Id.* Includes POPs scheduled to be deployed in 2000. Calculations based on nine carriers identified in prior table.

entrants' networks was comparable to that of WorldCom's network. Thus, unlike this proposed transaction, the MCI/WorldCom transaction did not reduce the number of national networks and left in place several new networks that either were (or could become in a relatively short period) comparable in scope to the WorldCom network.

III. Competition for Bundled Telecommunications Packages

A. Mass Market Bundles

40. The parties seek to defend their merger on the basis of a new market for so-called "all-distance" services. It is not clear whether they mean simply that customers will want to buy telecom services in bundles or whether they mean that all telecom services (including local as well as long distance) will be priced in the same manner (*e.g.*, 10 cents a minute for all local and long distance calls).

41. Given the expected importance of being able to offer bundled services, which Drs. Besen and Brenner discuss in their declaration,[27] the merger would decrease competition for bundled offerings. Currently, AT&T has a bundling strategy to offer residential customers a bundle of local, long distance, wireless, and cable television service in many instances. MCI WorldCom and Sprint currently are the only two other firms with established brand names and consumer recognition that currently can provide bundled offerings with the crucial component of long distance services. Furthermore, both Sprint and MCI WorldCom have adopted the strategy of providing the local

---

[27] *See* B&B Declaration, p. 57.

component of the bundle by means of fixed wireless (MMDS) or unbundled loops, *e.g.*, Sprint's Project ION service using DSL.

42. The FCC has recognized the competitive importance of the three brand name IXCs in providing competition in both long distance and local exchange mass markets for residential and small business customers. As the Commission recently stated in its SBC/Ameritech Decision:

> We also reaffirm our finding in prior decisions that the three largest interexchange carriers, AT&T, MCI (now MCI WorldCom), and Sprint are among the most significant participants in the mass market for local exchange and exchange access services. We find that these firms each have the capabilities, incentives, and stated intentions to serve the mass market for local exchange services. All three firms already have a substantial base of residential customers of their long distance services and established brand names resulting from their marketing of these services. Thus, these firms are among the best positioned to provide local services to residential customers. Further, their stated intentions to begin serving the mass market for local services underscores their position as being among the most significant competitors . . . . Other firms, currently serving or planning to serve the mass market for local exchange and exchange access services out-of-region, are not yet included in the list of most significant market participants. Competitive LECs have begun serving residential markets but do not yet have the existing customer base and brand name that enable AT&T, MCI, and Sprint, as well as certain incumbent LECs, to become most significant competitors. (*SBC/Ameritech Order*, ¶ 87-88, (footnotes omitted)).

If the acquisition of Sprint were to proceed, the number of significant competitors able to offer these bundles would decrease from three to two, because the BOCs are unable to offer these bundled services in-region where they have brand-name recognition.[28]

---

[28] It also is noteworthy that the FCC's findings that the three largest IXCs are among the most significant participants in local exchange services discredits MCI WorldCom and Sprint's claim that the proposed merger is needed to allow them to enter local exchange markets.

43. Unlike the market for long distance services, it would not be sufficient to avoid anti-competitive effects in an emerging market for bundled services to even have a significant proportion of residential customers covered by BOC long distance service. The law imposes no obligation on the IXCs to charge uniform nationwide prices for the non-interexchange portion of the bundle, such as currently exists for their long distance prices. Nor should any regulations be imposed that would require such behavior because economic inefficiency would be the result. Given the different cost conditions to provide local service in different geographical areas depending on population density, topography, local wages, local regulation of intrastate services and other factors, providers of bundled service need pricing flexibility to match differences in costs. Thus, providers of bundled services would likely charge different prices in different geographical areas depending on difference in costs and differences in competitive situations. For example, when SNET began offering long distance service in Connecticut, intense price competition occurred on intrastate long distance service because AT&T and MCI could not lower interstate prices for Connecticut only.

44. In the absence of nationwide pricing for bundles, to avoid the anti-competitive effects of this merger, it would be necessary for almost every BOC to receive Section 271 permission in almost every state. Otherwise, the current merger would lead to a significant decrease in competition for bundles in local geographic markets where the BOC had not yet received Section 271 permission. As an example, suppose that Bell Atlantic had received Section 271 permission in Massachusetts, New York, Pennsylvania, and Maryland, but it had not received permission in West Virginia. Thus, Bell Atlantic could not offer bundles in West Virginia nor could it constrain in West

Virginia the pricing power of the two remaining IXCs, AT&T and MCI WorldCom. By decreasing the number of brand name providers of bundled services from three to two, the merger would likely decrease competition in any state in which the BOC were unable to provide long distance service and offer bundles. Thus, under the merging parties' own theory of a so-called market for "all distance" communications services, the merger should not be permitted until BOCs receive Section 271 permission in almost every state.

B. Large Business Bundles

45. The Applicants' all-distance theory is also incorrect when applied to large businesses. For large businesses, the FCC has recognized that the crucial services in the bundle are long distance and data services.[29] The FCC has stated that brand recognition is less important for large business purchase decisions because of the level of sophistication of the buyers.[30] Again, at the current time the BOCs cannot participate in offering these bundles (except in New York) because they cannot provide either in-region interLATA long distance or interLATA data services without Section 271 permission.

46. The combination of Sprint with MCI WorldCom would drive data services to new heights of concentration. Sprint and MCI WorldCom are currently the second and third largest providers of packet switched data services.[31] After the merger, the combined

---

[29] *SBC/Ameritech Order*, ¶ 303.

[30] *Id.* ¶ 91.

[31] Packet-switched data services comprise a distinct communications service under the Merger Guidelines, which define markets based on demand substitution responses of consumers, because no substitute exists for consumers. MG, ¶ 1.0.

MCI WorldCom/Sprint would have a 48.4 percent market share as measured by revenues. This combined share would be over 40 percent larger than the next largest provider, AT&T.[32] For a large corporation with branches throughout the United States, AT&T and MCI WorldCom/Sprint would face no significant competition for data services post-merger. Thus, the merger could significantly affect competition.

47. The BOCs would be unable to fill this decrease in competition for bundled telecom/data services sold to large businesses. First, four BOCs exist, none of which currently has nationwide coverage. Also, so long as a BOC has not received Section 271 permission in all of its states, it is unable to offer a bundle to a corporation that had a presence in any in-region state where it lacks Section 271 permission. Thus, the BOCs would need to receive Section 271 permission in virtually every state before they could provide an effective competitive constraint on the merged companies.

IV. Internet Backbone Considerations

48. Internet backbone providers (IBPs) provide a key input component to Internet Service Providers (ISPs). The acquisition by MCI WorldCom of Sprint will combine the number one and number two IBPs. Large IBPs have the economic incentive and the ability to use their market power to impose supracompetitive interconnection agreements on smaller IBPs and ISPs. Large IBPs also have the incentive and ability to degrade the quality of interconnection with other parties on the Internet. Thus, the

---

[32] International Data Corp., *U.S. Packet/Cell-Based Services Market Share and Forecast: 1998-2003.*

acquisition will lead to an increase in market power and higher prices and lower quality to portals (*e.g.*, Yahoo) and ISPs, which will lead to higher prices to consumers.

49. Residential and business users access the Internet using modems with telephone lines or DSL and connect through a consumer chosen Internet Service Provider (ISP). Cable provides alternative access with a mandated ISP, either Excite@Home or Roadrunner. IBPs transmit data from ISPs throughout the U.S. and over many regions of the world using fiber optic transmission. Thus, the Internet is approximately a hierarchical structure with end use customers feeding into ISPs, which then feed into IBPs. To allow for connectivity, IBPs peer with each other. While initially peering took places at NAPs (Network Access Points), private peering has expanded so IBPs now exchange traffic at bilateral interfaces. Peering takes place with a "bill and keep" arrangement so that no money is exchanged among peers.[33] IBPs instead charge their direct customers for capacity and transmission usage.

A. Market Definition

50. The MG "hypothetical monopolist" approach is a useful tool in defining this product market. Because individual deals are made between IBPs and their customers, two classes of customers will be considered to highlight the analysis.[34] The first class consists of large buyers such as AOL, which, with approximately 20 million

---

[33] The alternative to bill and keep peering connections for connecting IBPs is a paying transit arrangement, under which one IBP pays a fee to a second IBP for the second to carry the first IBP's traffic.

[34] IBPs do not sell their capacity under tariff so that individual contracts are negotiated with customers.

customers, has a significant degree of buying power. Would AOL pay a 5-10% higher price if it faced a single IBP or would non-IBP sources of transmission capacity or AOL constrain the price? AOL likely would pay the higher price because an alternative source of supply or self-supply could not overcome the peering advantage held by the hypothetical monopolist IBP. The monopolist IBP could refuse to peer with alternative suppliers or AOL itself, or charge supracompetitive prices. Alternatively, it could degrade the peering quality. Given the sensitivity of a significant proportion of customers to significant waiting periods for their Internet content, AOL would be forced to pay the higher prices. Otherwise, it would lose a marginal group of customers to other ISPs that could offer lower prices or higher quality connections to the Internet.[35] Nor would AOL find it economical to self-supply, as indicated by its recent decision to exit the transmission business. If AOL did attempt to self-supply, refusal to peer by the hypothetical monopolist would likely force AOL to agree to supracompetitive prices. Thus, IBPs are a relevant product market for such customers.

51. The second customer class consists of smaller ISPs who lack the bargaining power and brand name of AOL.[36] These smaller ISPs pay more (per unit of volume) to IBPs, and their customers would tend to be more price sensitive and quality

---

[35] Because the incremental cost of serving an AOL customer is relatively low compared to the price and IBP payments are also low compared to price, AOL would only need to lose a small number of customers before it would pay the higher price. This result explains the high degree of attention paid to customer churn on AOL by financial analysts, because incremental cost is low compared to price, especially once customer acquisition costs are deleted.

[36] Very small ISPs typically do not deal directly with IBPs. Instead, they purchase service through another ISP.

sensitive, given that they do not find brand name or AOL content to be importance in their choices. While AOL might hypothetically self-supply, these smaller ISPs do not have that option. For these smaller ISPs, backbone costs are also a relatively small share of their incremental costs. Furthermore, these smaller ISPs are unlikely to find it economical to establish peering among themselves to avoid the monopoly backbone. Thus, the derived demand elasticity is likely to be low, and they would pay the 5-10% price increase from the monopolist IBP rather than engage in an alternative supply arrangement. Accordingly, IBPs also are a relevant product market for this group of customers.

B. Market Concentration

52. Market shares are quite difficult to collect for IBPs. For the U.S., Boardwatch Magazine publishes market share in terms of ISP connections. In its Summer 1999 Edition, it lists WorldCom as the number one provider with a 33% share while Sprint is the number two provider with a 10% share.[37] Thus, by this measure, the combined company would have a 43% share in a highly concentrated market (HHI above 1800) with a change in the HHI of 860. The EC ruling in 1998 on the MCI acquisition by WorldCom would imply similar levels of concentration in the EU or in a combined EU and US market.[38] Based on confidential data, the EC found WorldCom's revenue share to be between 35-45%, MCI's share to be between 5 and 15%, and their combined

---

[37] ISP Directory (11th ed. 1999).

[38] Commission Decision Case IV/M.1069 – WorldCom/MCI of 8 July 1998, 1999 O.J. (L 116).

revenue share to be over 50%. Given the increase in WorldCom's revenue share that appears likely based on its increase in the share of connections (described below) and the decline in share of MCI's divested business, it is likely that a combined WorldCom/Sprint would have a revenue market share of well over 50%.

C. Competitive Effects Analysis

53. The combined company, with approximately a 43% share of ISP connections, would be much larger than the second larger supplier. According to the Summer 1999 Boardwatch Magazine statistics, the next largest IBP would have approximately a 7% share. Unlike a smaller IBP, a larger IBP has an economic incentive for less connectivity since it faces less competition with decreased connectivity for ISP customers. A smaller IBP is more dependent on connectivity so for a given decrease in connectivity, the smaller firm would suffer a greater competitive disadvantage than the larger firm. The larger the divergence in size between the leading firm and competing firms, the more important this economic incentive becomes. As the relative difference becomes larger, the gap between the socially optimal degree of connectivity and the market determined outcome increases. Thus, an expected outcome of the acquisition of Sprint by WorldCom is a decrease in the level of connectivity below what it would be in the absence of the merger.

54. As the difference in connectivity grows between the dominant IBP and its much smaller rivals, the dominant IBP can also charge a higher price for its transmission services. This pricing power arises from the increased difference in connectivity between the dominant firm and its competition. The connectivity difference becomes a quality

differential for which customers are willing to pay higher prices. Thus, when backbones are approximately equal in size they have similar incentives in terms of connectivity and similar bargaining power. However, as one IBP becomes large relative to the others, its economic incentives diverge from the other IBPs, and its economic power increases relative to its competitors. Thus, the outcome where MCI WorldCom/Sprint vastly exceeds the size of its next largest competitors will lead to anti-competitive effects.

55. An additional problem arises with respect to IBPs that typically does not arise in unilateral effects analysis. Usually when a dominant firm increases its price, it will lose market share. Thus, the post-merger share of merging firms is likely to be smaller than the sum of the two pre-merger shares if market power is exercised. However, in the current situation, given the network effects and because of the importance of connectivity and its effect on quality, when the combined firm exercises market power its market share is likely to exceed the sum of the pre-merger shares since the anti-competitive effects degrade the quality of the smaller competitors more than they affect the dominant firm.

D. Effects of Multihoming and Divestiture

56. Large ISPs typically use "multihoming" as insurance against IBP network outages and other problems. Multihoming is the practice of ISPs and large customers of buying transit from more than one provider, which permits easy switching of traffic in case of network problems.[39] Also, ISPs do not want to peer across networks because it

---

[39] Multihoming has increased significantly between 1997-1999 according to

(Footnote continued...)

degrades performance; multihoming solves this problem, as well.[40] However, if the dominant IBP degrades its connectivity with smaller IBPs after the merger, ISPs will be able to observe the increased quality difference between the dominant IBP and their other IBP(s) at very small cost because of the presence of multihoming. The ISPs have already incurred the connection costs to multiple IBPs because of the use of multihoming so that the large IBP will not have to offer special incentive to cause ISPs to shift more of their traffic to the dominant IBP. Thus, multihoming increases the incentive of the dominant IBP to degrade connectivity, and the economic incentive increases with its size relative to the competitive IBPs. Multihoming exacerbates the effects of the acquisition in terms of competition.

57. Further, multihoming may cause divestiture of the smaller IBP network (here Sprint) to be an unsuccessful remedy. When a new owner acquires the smaller network, existing customers will have concerns over the quality of operation compared to the previous operation. The dominant IBP, WorldCom, can degrade the quality of connectivity to the divested network.[41] Customers will consider switching and because

---

(...continued)

estimates from Boardwatch Magazine.

[40] *See* <http://www.datareturn.com/frames.asp>, which explains why ISPs do not want to peer across networks. Peering between the different backbone providers does not allow ISPs to "optimize network performance for dynamic database driven content." Thus large ISPs purchase bandwidth from multiple bandwidth providers. An OECD Report discussed the high degree of multihoming in the U.S. "Internet Infrastructure Indicators," p. 21 (Oct. 23, 1998).

[41] Cable and Wireless claims that MCI WorldCom has engaged in these types of activities. *See* Testimony of Mike McTighe before the Commerce Committee of the U.S. Senate, Nov. 8, 1999.

of multihoming will find it less costly to switch than in the absence of multihoming. Because the larger backbone will know the identity of many of these customers because of multihoming arrangements and will already be present at many customer locations, it will have an advantage in gaining the divested company's business. The advantage will be proportional to its size relative to the competitive IBPs. Because WorldCom would be several times the size of a divested Sprint backbone, the competitive advantage would be significant. Thus, multihoming accentuates network effects and the competitive advantage of the largest IBP because of the low switching costs that arise in the presence of multihoming.

58. The effect of quality degradation and multihoming may explain, in part, the failure of the previous divestiture of the MCI backbone business to Cable and Wireless (C&W).[42] MCI's share was estimated to be significant prior to the divestiture with a 28% share of ISP connections. However, according to the Boardwatch Magazine 1999 statistics, C&W's share has decreased to about 6%, after acquiring MCI's backbone business. C&W is now the 4th largest IBP. Here are the before and after Boardwatch shares with respect to the divestiture:

[42] For Cable and Wireless's viewpoint, see *id.*

Table 4

Boardwatch Magazine Market Share Statistics: Backbone Connections

Carrier	Fall 1998 Share	Summer 1999 Share
MCI	28%	---
C&W	1%	6%

The ability of the dominant IBP to target its most significant competitors and reduce the ability of those competitors to compete because of degraded quality, combined with multihoming, may make divestiture of the Sprint IBP unworkable as a solution to the competition problem caused by the merger.

59. A further problem arises because of the uniquely and extremely fast-growing characteristic of the Internet. If an IBP does not continue to expand capacity rapidly, it will soon fall so far behind as to become competitively less significant. Indeed, MCI has claimed that it is expanding its capacity 1000 times per year. During the merger investigation, Sprint will have a decreased incentive to invest in expanding its own capacity because it realizes that the capacity will be divested. Given the importance of network effects and multihoming, the sale of a "degraded" asset with reduced capacity relative to its competitors will increase the probability of MCI WorldCom, the larger competitor, gaining additional demand post-merger. Thus, Sprint has an economic incentive to not increase its capacity as fast as it would in the absence of the merger. This decrease in capacity will result in decreased competition among IBPs, even if Sprint is later required to divest its backbone capacity.

V. Conclusions

60. The FCC-defined market of "mass market" long distance has three significant branded carriers: AT&T, MCI WorldCom, and Sprint, which have between 75%-80% of the mass market long distance market. MCI WorldCom and Sprint are each other's closest competitors. The combination of MCI WorldCom with Sprint would allow the exercise of unilateral market power by the combined company to raise (or not to lower) long distance prices to residential and small business customers.

61. Econometric analyses shows that elimination of Sprint by merger is likely to lead to price increases of 5.4% (for MCI's prices) and 8.9% (for Sprint's prices), all other things being equal. Furthermore, Sprint has a special position as the pricing innovator in segments of the mass market. A merger of Sprint with MCI WorldCom would lead to decreased pricing innovation and higher prices in the mass market. BOC entry will not fix this anti-competitive outcome in the relevant time frame. Also, the proposed acquisition of Sprint by MCI WorldCom would decrease competition for bundles of telecom services.

62. Lastly, the acquisition by MCI WorldCom of Sprint will combine the number one and number two IBPs. Large IBPs can use their market power to impose supracompetitive interconnection agreements on smaller IBPs and ISPs. The acquisition will lead to an increase in market power and higher prices to portals (*e.g.*, Yahoo) and ISPs, which will lead to higher prices to advertisers and consumers.

I, Jerry A. Hausman, hereby declare under penalty of perjury under the laws of the United States of America that the above is true and correct to the best of my knowledge and belief.

Dated: 16 Feb 2008